No. 2684

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MERCHANTS NATIONAL BANK OF SAN FRANCISCO (a corporation),

Petitioner,

vs.

THE CONTINENTAL BUILDING AND LOAN ASSOCIATION (a corporation) et al.,

Respondents,

In the Matter of Continental Building and Loan Association, Bankrupt.

BRIEF FOR RESPONDENTS.

HELLER, POWERS & EHRMAN,
HUGO D. NEWHOUSE,
REUBEN G. HUNT,
Attorneys for Respondents.

Filed this.....day of March, 1916.

FRANK D. MONCKTON, Clerk.

By.....Deputy Clerk.

No. 2684

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MERCHANTS NATIONAL BANK OF SAN FRANCISCO (a corporation),

Petitioner,

vs.

THE CONTINENTAL BUILDING AND LOAN ASSOCIATION (a corporation) et al.,

Respondents,

In the Matter of Continental Building and Loan Association, Bankrupt.

BRIEF FOR RESPONDENTS.

Statement of the Case.

(Italics are ours except where otherwise noted.)

While the statement of the case set forth in petitioner's brief is in the main correct, some matters have been omitted and others require correction. In speaking of "petitioner" throughout this brief we refer, of course, to the Merchants National Bank of San Francisco.

In its petition to revise addressed to this court, petitioner admits that the Continental Building

and Loan Association was *duly* adjudged a bankrupt on August 9, 1915 (Trans. p. 1). "Duly adjudged" means that the association presented to the District Judge a voluntary petition in bankruptcy in conformity with Official Form No. 2 prescribed by the Supreme Court of the United States in its General Order No. XXXVIII promulgated in accordance with the power conferred upon the court by Section 30 of the Bankruptcy Act. The petition in bankruptcy in the case at bar, therefore, following this official form, sets forth that "The corporation owes debts which it is unable to pay in full". This petition was accompanied, in the form of exhibits, by the schedules of liabilities and assets required by the said official form. The only persons listed in these schedules as creditors to whom the corporation owes debts are its shareholders (Trans. p. 60). The Merchants National Bank of San Francisco and the other creditors of its class, viz: Pacific Gas & Electric Co. and Grant Co., were not mentioned in these schedules. The referee in bankruptcy explains this omission by saying: "These claims are not scheduled by the bankrupt, being, as I am informed, inadvertently omitted" (Trans. p. 31).

The total indebtedness to shareholders listed in these schedules is $751,508.13 (Trans. p. 33). The total indebtedness due creditors of the class of petitioner is but $12,198.90, and of this sum there is due but $2611.20 to petitioner (Trans. p. 31).

Petitioner is in error in saying that at the first meeting of creditors held before the referee in

bankruptcy on September 15, 1915, "the only other creditor of the bankrupt present was the Pacific Gas & Electric Co.," for, in its petition to this court, petitioner states that Grant Co. was also present, and there was also present, at the meeting, as creditors, either in person or by proxy, over seven hundred shareholders with claims exceeding $500,000 (Trans. p. 60).

At this meeting the referee in bankruptcy did not refuse petitioner the right to vote for trustee until after petitioner had claimed priority of payment of its entire claim and had refused to waive such priority (Trans. p. 31).

Brief of the Argument.

I. Whether the shareholders of the bankrupt are creditors with provable claims or not, petitioner cannot vote for trustee because it claims priority of payment.

Bankruptcy Act, Sections 56b and 57e.

II. The bankruptcy of a building and loan association makes the shareholders creditors but gives "outside creditors", such as petitioner, the right to priority of payment.

(a) Upon the adjudication petitioner became a "Priority Creditor".

Bankruptcy Act, Chap. VI; Section 56b; Section 57e; Section 57g; Sections 60a-b.

(b) The adjudication was made upon theory that shareholders were creditors.

In re Gerber, 186 Fed. Rep. 693, 696; 26 Am. B. R. 608, 613.

(c) Petitioner cannot upset the theory of the adjudication except by a direct attack on the adjudication.

Collier on Bankruptcy, 10th Ed. p. 122;
Loveland on Bankruptcy, 4th Ed. pp. 346, 347;
Hanover National Bank v. Moyses, 186 U. S. 181, 190; 8 Am. B. R., 1, 10;
In re Fowler, No. 4998 Fed. Cas., 1 Low 161.

(d) Petitioner has assumed an inconsistent position.

(e) It is legally possible for the shareholders of a building and loan association to become creditors upon bankruptcy.

Coltrane v. Blake, 113 Fed. Rep. 785, 792;
Alexander v. Southern Home Building & Loan Association, 110 Fed. Rep. 267, 268.

(f) That shareholders become creditors upon bankruptcy is the effect of the decisions.

III. Shareholders of building and loan associations, having become creditors thereof in bankruptcy, have provable, and not contingent, claims.

Car v. Hamilton, 129 U. S. 252, 256; 9 Sup. Ct. 295, 32 L. Ed. 669;
Lovell v. St. Louis Life Ins. Co., 111 U. S. 264; 28 L. Ed. 423;
In re Mahler, 155 Fed. Rep. 428; 5 Am. B. R. 453, 457;
Watson v. Merrill, 136 Fed. Rep. 359; 14 Am. B. R. 453.

IV. Bankruptcy courts proceed upon equitable principles, and it would be inequitable to permit petitioner to control the election of a trustee.

In re Gerber, 186 Fed. Rep. 693, 696; 26 Am. B. R. 608, 613.

Argument.

I.

WHETHER THE SHAREHOLDERS OF THE BANKRUPT ARE CREDITORS WITH PROVABLE CLAIMS OR NOT, PETITIONER CANNOT VOTE FOR TRUSTEE BECAUSE IT CLAIMS PRIORITY OF PAYMENT.

There is no escape from this proposition. Petitioner avoids this subject in its brief until the very end and then dismisses it with but a paragraph. It is really the vital point on this appeal and all of the other discussions contained in petitioner's brief are beside the point.

Creditors claiming priority of payment, like petitioner here, cannot vote for trustee (Section 56b of the Bankruptcy Act). This provision is statutory and must be obeyed. There is no exception. For this reason alone, if for no other, the order of the District Judge should be affirmed.

Petitioner has not in any wise been prejudiced by being denied the right to vote for trustee. When petitioner appeared at the first meeting of creditors and attempted to control the election of a trustee the referee required petitioner to elect

whether or not it claimed priority, and upon being informed that it did claim such priority and refused to waive the same, denied it the right to vote. This was in strict compliance with Sections 56b and 57e of the Bankruptcy Act.

On account of the priority nature of its claim petitioner is not interested in the election of a trustee. The theory of the Bankruptcy Act is to exclude from participation in the choice of a trustee those creditors who are sure of payment before all others and to put the selection in the hands of those who must take a chance on the outcome after such priority creditors are paid. Bankruptcy ordinarily means that all creditors will not be paid in full. Priority creditors will be paid in full, or at least will be paid before all others. Unsecured creditors, like the shareholders in this proceeding, will not be paid in full, and the amount that they recover depends entirely upon the nature of the assets and the skill with which these assets are liquidated. The interest of the shareholders, therefore, is purely speculative. The losses, if any, must fall upon them. For this reason Congress has wisely provided in the Bankruptcy Act that unsecured creditors like the shareholders, and not priority creditors like the Merchants National Bank of San Francisco, shall be the ones who have a right to pick the trustee upon whom so much depends for substantial returns upon their claims.

II.

THE BANKRUPTCY OF A BUILDING AND LOAN ASSOCIATION MAKES THE SHAREHOLDERS CREDITORS BUT GIVES "OUTSIDE CREDITORS", SUCH AS PETITIONER, THE RIGHT TO PRIORITY OF PAYMENT.

(a) Upon the Adjudication Petitioner Became a "Priority Creditor."

There are but four classes of creditors recognized by the Bankruptcy Act: Secured, priority, preferred and unsecured (Bankruptcy Act, Chap. VI). Secured and priority creditors cannot vote for trustee, where their debts are fully secured, or priority is claimed for the *full* amount (see Section 56b of the Bankruptcy Act). Preferred creditors, or those that have received preferential payments voidable by the trustee under Section 60a-b of the Bankruptcy Act, cannot vote until they have surrendered such preferences to the trustee (Bankruptcy Act, Section 57g). The only creditors that can vote for trustee, then, are those of the unsecured class, for where secured creditors are not fully secured, and priority creditors do not claim full priority, their claims are unsecured to that extent, likewise preferred creditors who surrender their preferences.

There is no dispute over the proposition that upon the bankruptcy of a building and loan association "outside creditors", without security or preferences, such as petitioner here, are entitled to be paid in full prior to any payments to the shareholder creditors. The authorities supporting this proposition are unanimous and the rule requires

no citation. Petitioner takes this position in this proceeding and is not opposed. This being so, the effect of the bankruptcy of a building and loan association "duly adjudicated", as in this case, is to relegate such "outside creditors" to the priority class, without power to vote for trustee, and the shareholders to the unsecured class with the exclusive power to vote for trustee.

(b) The Adjudication Was Made Upon Theory That Shareholders Were Creditors.

Petitioner would have us believe that the only purpose of the bankruptcy proceeding was to pay off these "outside creditors". The assets of a bankrupt corporation can be used only in payment of expenses of administration and dividends to creditors. Should there be a surplus this must be returned to the bankrupt. In the case at bar therefore, if petitioner's position be sound, only enough of the $750,000 assets can be administered upon to pay off the "outside creditors" $12,198.90, and the balance of these vast assets must be then turned back to the corporation. Petitioner's trustee could not dispose of this balance in any other way; he could not distribute among the shareholders, because, as petitioner asserts, the shareholders are not creditors.

That petitioner's position leads to an absurdity it quite apparent from the foregoing. It cannot be said that the bankrupt intended to walk right into the bankruptcy court, pay off $12,000 of liabilities with $750,000 of assets, turn right around and walk

right out again. The bankrupt sought the aid of the bankruptcy court to liquidate its entire affairs upon equitable principles (in re Gerber, 186 Fed. Rep. 693, 696; 26 Am. B. R. 608, 613), treating all with claims against the bankrupt as creditors, but giving the so-called "outside creditors" a priority. As Judge Dooling well said in his opinion (Trans. p. 60):

> "The question as to whether the shareholders can be at the same time creditors, is an interesting one, but under the peculiar circumstances of this case need not be definitely determined at this time. The adjudication was had upon the petition of the corporation itself. The shareholders were named in the petition as creditors. If they are not creditors within the meaning of the Bankrupt law the corporation is not insolvent as the only other claims amount to about $12,198.90, while the assets of the corporation are scheduled at $769,508.13. If, therefore, the shareholders are eliminated as creditors we have these vast assets with which to pay debts of $12,198.90. No one interested has made any objection to the adjudication, and so long as it stands based on the theory that the shareholders are creditors, they must be regarded as creditors for all purposes. The Merchants National Bank will be paid in full whatever happens to the shareholders' claims."

The adjudication was, and must have been, made upon the theory that the shareholders were creditors, as set forth in the schedules, otherwise the corporation would not have been subject to adjudication because it would not have been "unable to pay its debts in full", and would have been with-

out creditors, the "outside creditors" not having been mentioned. Petitioner admits the adjudication was "duly made" (Trans. p. 1), and is bound by the implied determination in such adjudication, which determination was necessary to its validity, that the shareholders are creditors. If petitioner has any grievance it is that the adjudication should never have been made at all. Having suffered to remain unchallenged all this time an adjudication based upon the theory that the shareholders are creditors within the meaning of the Bankruptcy Act, petitioner is now estopped to deny that the shareholders are such creditors.

(c) Petitioner Cannot Upset the Theory of the Adjudication Except by a Direct Attack on the Adjudication.

Before a corporation can file a voluntary petition in bankruptcy it must have certain qualifications. *First,* it must owe debts to creditors who have provable claims in bankruptcy. In the case at bar the petition and schedules filed by the Continental Building and Loan Association shows that it owes debts to a very large number of shareholder creditors, but to no other creditors, and that these shareholder creditors have provable claims against the corporation in bankruptcy.

> Collier on Bankruptcy, 10th Ed. p. 122;
> Loveland on Bankruptcy, 4th Ed. pp. 346, 347.

Second. It must appear that the corporation is unable to pay these debts in full. An allegation to

this effect was made in the petition in the case at bar and was accepted as true by the District Judge when he made the adjudication. While the amendment of 1910 to Section 4 of the Bankruptcy Act has omitted the clause "owing debts", there seems no good reason for the elimination of these words, and it is probable that the change was inadvertent and should be considered as an error. It does not materially affect the operation of the act, for it is obvious that there can be no bankruptcy without the existence of debts. It must still be held that a corporation must owe a debt or debts in order to become qualified to become a voluntary bankrupt.

Collier on Bankruptcy, 10th Ed. page 122.

The Supreme Court of the United States in the case of Hanover National Bank v. Moyses, 186 U. S. 181, 8 Am. B. R. 1, 10, said at page 190 of 186 U. S., and 10 of 8 Am. B. Rep.:

> "The act provides that 'any person who owes debts, except a corporation shall be entitled to the benefits of this act as a voluntary bankrupt' (Sec. 4a), and that 'upon the filing of a voluntary petition the judge shall hear the petition and make the adjudication or dismiss the petition' (Sec. 18g). With the petition he must file schedules of his property, and 'of his creditors, showing their residences, if known, if unknown, that fact to be stated' (Sec. 7, subd. 8). The schedules must be verified, and the petition must state that 'petitioner owes debts which he is unable to pay in full', and 'that he is willing to surrender all his property for the benefit of his creditors, except such as is exempt by law'. This estab-

lishes those facts so far as a decree of bankruptcy is concerned."

The order of adjudication in the case at bar, therefore, unless set aside or reversed by an appellate court, is conclusive upon the point that the corporation owes to its shareholders as creditors debts founded upon claims provable in bankruptcy (In re Fowler, No. 4998 Fed. Cas., 1 Low 161), and petitioner is estopped and precluded to deny the effect of the adjudication in this respect except by some direct proceeding either in a petition to set aside the adjudication or on an appeal from the adjudication.

(d) Petitioner Has Assumed an Inconsistent Position.

Not only this but the very position which petitioner now assumes is inconsistent with any other theory than that the shareholders are creditors. This appears if we consider, for a moment, that this proceeding revolves around the election of a trustee, petitioner claiming that it is the only creditor capable of voting upon such a matter. But, clearly, petitioner can have no standing to make any claim whatsoever in reference to such election unless there has been a valid adjudication that the Continental Building and Loan Association is a bankrupt, for if it were not so adjudicated there would be no necessity of electing a trustee, and in fact no authority to do so. Petitioner's position, therefore, is founded upon the fact that there is a valid adjudication, and if there has been a valid adjudication it could only have been made upon the theory that the shareholders are creditors, be-

cause they were the only persons mentioned in the schedules as such. If they are not creditors, the bankrupt has more than sufficient assets to pay its debts—does not owe debts it cannot pay in full. So that petitioner cannot on the one hand take a position that must concede that the shareholders were creditors for the purpose of obtaining an adjudication of the association's bankruptcy, and on the other hand (and when such adjudication is accomplished) face about and claim that these same shareholders are not creditors. To sum up, if the shareholders are not creditors there could be no proceeding in bankruptcy and petitioner would not now be seeking relief against the action of the District Court and the referee.

(e) It Is Legally Possible for the Shareholders of a Building and Loan Association to Become Creditors Upon Bankruptcy.

The first point made by petitioner in its brief is that

> "a shareholder of a corporation is a distributee of its assets after all claims against the corporation are paid, and it is legally impossible for such a shareholder, pursuant to the transaction by virtue of which he becomes a shareholder, to be a creditor of the corporation within the meaning of the Bankruptcy Act" (Petitioner's Brief, p. 7).

Petitioner goes on to say in its brief: "The proposition of law contained in the foregoing is self-evident and we suppose will not be disputed". It is disputed, however, and is not self-evident, or evident at all.

It is true that the situation presented in the case at bar is peculiar and unusual. That does not mean, however, that we must allow ourselves to become tangled up in a maze of technicalities and to be led astray from a plain, common-sense solution of the situation that will enable the court to do substantial justice to all and permit the bankruptcy to proceed along the lines initiated. We must bear in mind that there is a big difference between the shareholder of a building and loan association, whose capital stock consists of the dues paid in by their members together with the apportioned profits, and a stockholder of an ordinary commercial corporation. The difference lies in the absolute right of every shareholder to withdraw at any time from the association and receive what he has paid in plus his share of the profits earned and minus the penalties imposed for withdrawal, without being compelled to complete his stock subscription. This difference is well explained by the referee in bankruptcy (Trans. pp. 36 and 37):

> "But there is another principle of these associations to be considered, and out of which a condition of insolvency may arise, peculiar to such associations, and that is the right given by law to every member to withdraw from the association and receive such an amount of what he has paid in, and profits earned, less penalties for withdrawal, provided by law. The right of withdrawal is absolute. While by virtue of his membership he is liable for the debts of the corporation to outside creditors in the proportion represented by his stock, as between the association and himself, the association cannot compel him to complete his stock subscription. There is, therefore, an absolute

> obligation on the part of the association to pay all members such withdrawal value, and this establishes a condition of debtor and creditor.
>
> To the extent of the obligation of the corporation to pay the withdrawal value of the stock based upon profits actually existing the identity of the corporation is distinguished from that of its members. If the corporation is solvent they can in law or in equity recover such withdrawal value. If the corporation is unable to pay back the principal paid in a state of insolvency exists. In the opinion of the referee the stockholders have provable claims in bankruptcy to this extent, and are entitled to their proportionate share of the profits, if any."

When a building and loan association goes through bankruptcy, it is this capital, or what is left of it, that is divided among the shareholders. Even in the case of ordinary commercial corporations, the courts hold that stockholders are creditors when it comes to a division of the capital upon insolvency, subject to the prior payment of claims of "outside creditors" (Coltrane v. Blake, 113 Fed. Rep. 785, 792). In the case of Alexander v. Southern Home Building & Loan Association, 110 Fed. Rep. 267, the court, at page 268, said:

> "When the bill in this case was filed the association was not insolvent, in the proper sense of the term. There were no debts to outside creditors of any importance. The mass of the obligations of the association were due and to become due to its members, who occupied the position of stockholders, with the right to become eventual creditors. The association is in the hands of the court for settlement and winding up because, for the many

reasons stated in the bill, it is impossible to carry out the objects and purposes of the association. The practical effect of the appointment of the receiver for the purpose of winding it up is to turn or transform all the stockholders into creditors, and thus make the association insolvent; and the course to pursue under the bill is to collect the assets and distribute them as justice and equity require."

(f) That Shareholders Become Creditors Upon Bankruptcy Is the Effect of the Decisions.

Petitioner cites a large number of cases in its brief (Petitioner's Brief, p. 23) in attempting to establish its fifth point that the decisions of the courts are uniform to the effect that shareholders in a building and loan association are not creditors. An examination of these authorities reveals that they all agree upon the proposition that upon bankruptcy shareholders are creditors after the outside debts are paid. What difference is there, in substance, between such a statement, and respondents' position that both shareholders and outsiders are creditors upon bankruptcy, with the outside creditors entitled to priority of payment over the shareholder creditors? It is a familiar maxim of jurisprudence that courts respect form less than substance (Civil Code Cal., Sec. 3528).

III.

SHAREHOLDERS OF BUILDING AND LOAN ASSOCIATIONS, HAVING BECOME CREDITORS THEREOF IN BANKRUPTCY, HAVE PROVABLE, AND NOT CONTINGENT, CLAIMS.

The next point made by petitioner in its brief is that

> "No person can vote for the office of trustee unless he has a provable claim against the bankrupt, and shareholders of a corporation do not possess, by virtue of their shareholding, provable claims against the bankrupt within the meaning of the Bankrupt Act" (Petitioner's Brief, p. 9).

Petitioner then engages in a long discussion attempting to show that the nature of the claims of shareholders is contingent and not that of a fixed liability absolutely owing at the time of the filing of the petition in bankruptcy. This proposition is well answered by the referee in bankruptcy in the quotation we have cited above (page 14 of this brief and Trans. pp. 36, 37).

Petitioner further states in its brief (Petitioner's Brief, p. 12): "It is clear that the liability of the corporation to its stockholders is wholly of a contingent character. The amount of that liability is not capable of definite ascertainment", but petitioner fails to show how this liability is contingent, or why it is not capable of definite ascertainment.

The liability of the corporation to the shareholders is not dependent upon contingencies that may or may not happen in the future. When it ceased its business by bankruptcy the Continental Building and Loan Association turned over its property to the bankruptcy court and became liable to its shareholders for the amounts paid in by them as dues, plus their apportioned share of the profits, if any. This is the most that the corporation could be liable for in any event, past, present or future. The amount paid in as dues by the shareholders is fixed and capable of ascertainment from the books

of the corporation as of the date of the filing of the petition in bankruptcy. The amount of profits, if any, are likewise also capable of ascertainment. There will be no further dues paid in, and no further profits earned, after the filing of the petition in bankruptcy, for the reason that the corporation has ceased to do business, and so there is nothing in the future to figure on in determining the "fixed liability absolutely owing at the time of the filing of the petition".

As was said by Mr. Justice Bradley, referring to a life insurance company which had gone into liquidation, in Car v. Hamilton, 129 U. S. 252, 256, 9 Sup. Ct. 295; 32 L. Ed. 669:

> "By that act the company becomes *civiliter mortuus*. Its business is brought to an absolute end, and the policy holders become creditors to an amount equal to the equitable value of their respective policies, and entitled to participate pro rata in its assets."

A parallel case, in principle, is found in Lovell v. St. Louis Life Ins. Co., 111 U. S. 264, 28 L. Ed. 423, in which the court held that where an insurance company had terminated its business and transferred its assets and policies to another company whereby it totally abandoned the performance of its contracts by transferring all of its assets and obligations to the new company, it thereby authorized the insured to treat the contract as at an end and to sue to recover back the premiums already paid, although the time for the porformance of the obligation, to wit: the death of the insured, had not arrived.

In the case at bar, upon the bankruptcy of the association the shareholders were authorized to treat their relations with the corporation as at an end and to file claims based upon the withdrawal value of their shares as fixed by the by-laws even though they had not yet exercised the right of withdrawal, and even though the time for the performance of the obligations incurred by the association, to wit: the full payment of dues or the withdrawal by the shareholder, had not arrived.

Petitioner cites in its brief a great many cases relating to contingent claims, most of which are cases where attempts have been made to establish claims in bankruptcy proceedings based upon rent yet to accrue under a lease (Petitioner's Brief, p. 11). It is well established that rent to accrue upon a lease after bankruptcy is not a provable claim against the estate. As was said in the case of In re Mahler, 155 Fed. Rep. 428, 5 Am. B. R. 453, 457:

> "It is clear that the claim for future rent is not 'a fixed liability * * * absolutely owing at the time of the filing of the petition against him' (the bankrupt) because before the day at which rent is covenanted to be paid it is in no sense a debt. It is neither debitum nor solvendum; for, if the lessee is evicted before that day, it never becomes payable. Bordman v. Osborn, 23 Pick. 295; Savory v. Stocking, 4 Cush. 607; Deane v. Caldwell, 127 Mass. 242; Wilder v. Peabody, 37 Minn. 249, 33 N. W. 852; In re Commercial Bulletin Co., 2 Woods. 220, Fed. Cas. No. 3,060. It is said by Chief Justice Gray in the case of Deane v. Caldwell: 'It is not an existing demand, the cause

of action for which depended upon a contingency, but the very existence of the demand depended upon a contingency.' A covenant to pay rent quarterly creates no debt until it becomes due, for before that time the lessee may quit, with the consent of the lessor; or he may assign his term with his consent; or he may be evicted by a title paramount to that of the lessor. In either of such cases he will be discharged from his covenant. Wood v. Partridge, 11 Mass. 488. It is not an unliquidated claim, capable of valuation, which may be proved and allowed after its amount has been ascertained. The general intent of Congress in the enactment of the statute was to make every debt and demand existing against the bankrupt at the time of his adjudication, which was recoverable either at law or in equity, provable in bankruptcy. This provision, however, is evidently intended to include and permit the proof of such claims then existing as are uncertain only in amount."

And also in the syllabus to the case of Watson v. Merrill, 136 Fed. Rep. 359, 14 Am. B. R. 453:

"Rents which the bankrupt had agreed to pay at times subsequent to the filing of the petition in bankruptcy do not constitute a provable claim under the Bankruptcy Law of 1898, because they are not a fixed liability * * * absolutely owing at the time of the filing of the petition against him, and because they do not constitute an existing demand, but both the existence and the amount of the possible future demand are contingent upon future events, such as default of lessee, re-entry of lessor, and assumption by trustee, so that they neither form the basis of an unliquidated nor of a liquidated provable claim."

The distinction between the provability of claim for rent to accrue after bankruptcy and the provability of the claims of the shareholders in the case at bar is obvious. Neither the existence nor the amount of the claims of the shareholders depend upon future events. As we pointed out above, they both become fixed and capable of ascertainment at the date of the filing of the petition. There is absolutely nothing that can happen in the future that will in any way affect the fixing of the amount of the liability as of the date of the filing of the petition, and petitioner has not attempted to suggest any such contingency, for there is none.

IV.

BANKRUPTCY COURTS PROCEED UPON EQUITABLE PRINCIPLES, AND IT WOULD BE INEQUITABLE TO PERMIT PETITIONER TO CONTROL THE ELECTION OF A TRUSTEE.

It is well established that bankruptcy courts proceed upon equitable principles (see In re Gerber, 186 Fed. Rep. 693, 696; 26 Am. B. R. 608, 613). It does not require any extended argument on our part to show the injustice of permitting the Merchants National Bank of San Francisco to control the election of the trustee. The matter is well put by the referee in bankruptcy who says (Trans. p. 33):

> "The Merchants National Bank is an outside creditor, having a claim for $2,611.20. It takes the position that as the stockholders are liable for the debts of the corporation, its claim is entitled to priority, and must be paid in full. Its petition for review is based upon the proposition that the outside creditors alone are en-

titled to name the trustee; that stockholders of the bankrupt are disqualified. At the meeting of September 15th, 1915, counsel for the Merchants National Bank sought to vote this claim and to exclude all stockholders from participating in the election. In my opinion the taking of this petition to review emanates from the office of counsel for the bankrupt. It is represented by an attorney associated with the attorney for the bankrupt. In addition to said Merchants National Bank there are only two creditors who are not stockholders, and their claims amount to $9,587.70.

Considering that the indebtedness to the stockholders as scheduled amounts to $751,-434.65, and that the assets which are scheduled at $769,508.13, will, with the exception of the few outside creditors named, be distributed to the stockholders, I can have no patience with a creditor who is claiming the right to be paid in full and who attempts to take the administration of this estate upon a claim of $2,-611.20 out of the hands of creditors representing $751,434.75 upon a technicality of the kind presented. In my opinion this is a further attempt upon the part of officers of the Continental Building & Loan Association to control the administration of this estate."

Having taken complete jurisdiction over the assets of the bankrupt by reason of the filing of the petition and the subsequent adjudication, the bankruptcy court will proceed to administer upon these assets in accordance with equitable principles, that is to say, will see that creditors like the Merchants National Bank of San Francisco are paid in full as "priority creditors", and the balance of the creditors, to wit, the shareholders, receive the remainder of the estate pro rata according to their respective

claims. In view of the fact that most of the assets consist of loans made by the bankrupt upon real estate security, the pro rata that the shareholders receive depends a great deal upon the skill with which the estate is managed, that is to say, upon the qualifications of the trustee selected. The interests of the Merchants National Bank of San Francisco are not at all at stake for there are ample assets to pay it in full many times over, but the interests of the shareholders are at stake because the assets are apparently not sufficient to pay them in full, and the amount of their recoveries depends largely upon the manner in which the estate is handled. Surely, under these circumstances, it would be inequitable to permit the Merchants National Bank of San Francisco to select a trustee as against the shareholders, when the interests of the Merchants National Bank of San Francisco are so insignificant as compared with the interests of the shareholders.

CONCLUSION.

In conclusion, we respectfully submit that, for the foregoing reasons, the order under review should be affirmed.

Dated, San Francisco,
March 21, 1916.

HELLER, POWERS & EHRMAN,
HUGO D. NEWHOUSE,
REUBEN G. HUNT,
Attorneys for Respondents.